Bath & North East Somerset Council		
MEETING:	**AVON PENSION FUND INVESTMENT PANEL**	
MEETING DATE:	**24 MAY 2017**	**AGENDA ITEM NUMBER**
TITLE:	**Review Of Investment Performance For Periods Ending 31 March 2017**	
WARD:	**ALL**	
AN OPEN PUBLIC ITEM		
List of attachments to this report: Appendix 1 – Fund Valuation Appendix 2 – Mercer performance monitoring report (Panel version) Exempt Appendix 3 – RAG Monitoring Summary Report		

1 THE ISSUE

1.1 This paper reports on the performance of the Fund's investment managers and seeks to update the Panel on routine aspects of the Fund's investments. The report contains performance statistics for period ending 31 March 2017.

1.2 The report focuses on the performance of the individual investment managers. The full performance report with aggregate investment and funding analysis will be reported to the Committee meeting on 23 June 2017.

1.3 This is the fourth quarter that performance measurement has been provided by BNY Mellon, the Fund's custodian. The former provider, SSGA (WM Performance Services) withdrew from providing this service to non-custody clients at the end of 1Q16.

2 RECOMMENDATION

That the Investment Panel:

2.1 **Notes the information as set out in the reports.**

2.2 **Identifies any issues to be notified to the Committee.**

3 FINANCIAL IMPLICATIONS

3.1 The returns achieved by the Fund for the three years commencing 1 April 2016 will impact the next triennial valuation which will be calculated as at 31 March 2019. The returns quoted are net of investment management fees.

4 INVESTMENT PERFORMANCE

A – Fund Performance

4.1 The Fund's assets increased by £158m (c. 3.8%) in the quarter ending 31 March 2017 giving a value for the investment Fund of £4,356m. Appendix 1 provides a breakdown of the Fund valuation and allocation of monies by asset class and managers.

4.2 Upward momentum in developed market equities initially continued into Q1 2017 but started to correct as the market questioned Trump's ability to implement healthcare, taxation and regulatory reforms. Equity market valuations appear to remain stretched and the prospect of unified interest rate increases from developed economies could lead to a more material downward move in the medium-term. Despite waning risk appetite among investors the FTSE 100 posted all-time highs in March and UK business activity growth hit a three-month high in the same month. Inflation rose both in the UK and Europe as a result of high oil prices and 'imported inflation' as a result of weak domestic currency. This kept real wage growth under pressure. It is worth noting that oil prices did decline through the quarter as the oversupply in this market persisted despite commitment from OPEC countries to further production cuts. This could act to curb any significant spikes in inflation in the short- to medium-term. The US Federal Reserve sought to head off rising inflation with the second interest rate rise in three months, taking the base rate from 0.75% to 1%. A tightening in US monetary policy tends to increase the cost of borrowing for many emerging market economies but this did not seem to impair returns this quarter as emerging markets performed well on a perceived mellowing of Trump's protectionist rhetoric and a number of upside surprises in China's economic data. There is increasing speculation that the ECB may follow the Fed by reducing their quantitative easing program and tightening monetary policy through rate hikes in 2017. Benchmark 10-year bond yields rose marginally in most European countries in the quarter as a result of increasing inflation. Conversely, UK 10-year yields fell by c.0.20%, consistent with the scaling-back in equity market performance toward the end of the quarter. In the currency markets, the USD broadly weakened. While sterling posted gains against the US dollar, it depreciated against the Yen and Euro.

4.3 The Fund's overall performance relative to benchmarks is unavailable at the time of publishing. Full performance data will be reported to the Pensions Committee on 24 June 2017.

B – Investment Manager Performance

4.4 A detailed report on the performance of each investment manager has been produced by Mercer – see pages 25 to 45 of Appendix 2.

4.5 All but one manager posted positive absolute returns over the quarter, reflective of wider market returns. The exception was Standard Life GARS who achieved -0.3% following a return of +1.8% last quarter.

4.6 Relative returns were disappointing with the majority of managers underperforming their targets, both on a quarterly and a 3 year rolling basis. This

quarter Jupiter, Schroder (Global Equities), TT, Unigestion and Pyrford remain on an 'Amber' rating and are joined by Genesis. On a 3 year basis RLAM and Invesco underperformed but remain above the threshold as outlined in the RAG framework and therefore retain their 'Green' rating. Schroder Property retain their 'Green' rating based on the fact their performance is assessed on a rolling 5 year basis and is within tolerance of their performance target. Partners retain their 'Green' rating as their performance is based on net IRRs since inception, which continue to meet expectation. Precise detail of amber rated managers can be found at Exempt Appendix 3. Only the enhanced indexation manager (SSgA) and the passive manager (BlackRock) met their performance targets over 3 years

4.7 Among the managers that are yet to reach the 3 year mark SLI were not able to continue their improved performance from Q416 and recorded a negative absolute return of -0.3% over the three-months to 31 March 2017. JP Morgan achieved a quarterly absolute return of +1.3% in USD terms and IFM posted 6.7% net IRR since inception, again in local currency terms.

4.8 Exempt Appendix 3 summarises the latest Performance Monitoring Report used internally to monitor manager performance. The summary report highlights the managers that are rated amber or red, detailing the performance and/or organisational issue(s), how they are being monitored and any actions taken by Officers and/or the Panel. Schroder (global equity mandate), Jupiter, TT Unigestion and Pyrford have retained amber ratings this quarter, Genesis have been added to the report as they are now sufficiently below the threshold and also receive an amber rating.

5 INVESTMENT STRATEGY AND PORTFOLIO REBALANCING

5.1 **Asset Class Returns versus Strategic Assumptions**: All asset classes with the exception of hedge funds met their assumed strategic returns on a 3 year basis. Index returns from developed and emerging equities, index-linked gilts, property and infrastructure are significantly ahead of their assumed strategic returns on a 3 year basis. Hedge funds remain below long-term averages due in part to exceptionally low cash rates.

5.2 **Risk Management Framework**: In November the Panel delegated the setting of the trigger levels to Officers in consultation with the Investment Consultant, Actuary and Manager, at the time of implementation and once implemented that Panel members should be notified when triggers were changed or activated. Officers are in the process of finalising the trigger framework and investment management agreement and there is a Panel Workshop with the manager and Mercer on 24th May following the formal Panel meeting which will update the Panel.

5.3 **Infrastructure**: Following drawdown of $105m in Q117 all commitments have now been drawn-down and the infrastructure allocation is fully invested.

5.4 **MIFID II**: The FCA will release details of the opt-up criteria LGPS will need to satisfy in order to be re-classified as a 'professional counterparty' from the default position of 'retail counterparty'. Once the FCA has made its position clear the Fund will work towards satisfying the revised tests to meet an 'elective professional status'. The deadline for implementation of MIFID II is 3 January 2018.

5.5 **Currency Hedging**: Since the result of the EU referendum, Sterling has fallen significantly against other major currencies (increasing the local market value of non-sterling assets). This trend reversed slightly in Q1 versus the dollar with the pound appreciating against the dollar by c1.2% although sterling continued to weaken against the euro and yen over the quarter. Given the majority of hedging activity is versus the dollar, the currency hedge on the non-sterling assets has added value to local currency returns on infrastructure, hedge funds, and to a lesser extent, overseas equities and property. The Consultant and Officers reaffirmed their position on currency hedging at September 2016 Panel and will further review the efficacy of the hedge at the strategic review in June 2017.

5.6 **Cash Management**: A total of £105m GBP equivalent was sold from BlackRock overseas equity funds in the quarter to fund the final drawdown in infrastructure and to meet currency hedging cash requirements necessary to maintain a 50% passive hedge level. After quarter end the Fund received c£84m in up front deficit payments from employers. On advice from Mercer this has been placed in cash liquidity funds in the short-term, pending the outcome of the ongoing investment strategy review. This relatively high cash balance will be reviewed on a monthly basis.

5.7 **Rebalancing:** As at 10th May asset allocations remain within the acceptable range requiring no rebalancing action. Officers did not undertake any rebalancing activity during the quarter.

5.8 **Manager Meetings:** The Panel are meeting BlackRock and Unigestion in a Workshop on 24th May following the formal Panel meeting.

6 RISK MANAGEMENT

6.1 The Avon Pension Fund Committee is the formal decision-making body for the Fund. As such it has responsibility to ensure adequate risk management processes are in place. A key risk to the Fund is that the investments fail to generate the returns required to meet the Fund's future liabilities. This risk is managed via the Asset Liability Study which determines the appropriate risk adjusted return profile (or strategic benchmark) for the Fund and through the selection process followed before managers are appointed. This report monitors the performance of the investment managers. The Investment Panel has been established to consider in greater detail investment performance and related matters and report back to the Committee on a regular basis.

7 EQUALITIES

7.1 An equalities impact assessment is not necessary as the report is primarily for information only.

8 CONSULTATION

8.1 This report is primarily for information and therefore consultation is not necessary.

9 ISSUES TO CONSIDER IN REACHING THE DECISION

9.1 The issues to consider are contained in the report.

10 ADVICE SOUGHT

10.1 The Council's Section 151 Officer (Divisional Director – Business Support) has had the opportunity to input to this report and has cleared it for publication.

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Background papers	Data supplied by BNY Mellon Performance Measurement
Please contact the report author if you need to access this report in an alternative format	